IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 191

JOHN K. BERETTA, PETITIONER,

versus

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

Petition for Writ of Certiorari

TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

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LODOVIC PRINTING CO., SAN ANTONIO, TEXAS

SUBJECT INDEX.

LIST OF AUTHORITIES.

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TO THE HONORABLE THE SUPREME COURT OF THE UNITED STATES:

Petitioner, John K. Beretta, respectfully shows:

I.

SUMMARY STATEMENT OF THE MATTERS INVOLVED.

Petitioner seeks a review of a judgment of the United States Circuit Court of Appeals for the Fifth Circuit, af-

firming a decision of the Tax Court, which redetermined a deficiency of income tax for the year 1937, imposed by the Commissioner of Internal Revenue, in the amount of $3892.40.

The sole matter at issue is whether certain money received by the Petitioner as a corporate stockholder was in partial liquidation of the corporation, so as not to be taxable to him as ordinary income.

The facts are wholly undisputed, the Findings of Fact of the Tax Court (R. 19-27) being based upon a Stipulation of Facts (R. 52-81).

The facts are stated fairly accurately, and with several exceptions completely, in the Opinion of the Court below, 141 F. (2d) 452. (R. 87). We state them somewhat more briefly.

The taxpayer was a stockholder in the Laredo Bridge Company, a Texas corporation, owning and operating a toll bridge across the Rio Grande River between Laredo, Texas, and Nuevo Laredo, Mexico, and this bridge constituted the principal asset of the corporation (R. 19-21, 52-3).

On June 6, 1937, the concession by the Mexican Government under which this bridge had been constructed expired, and Mexico took over that end of the bridge, at two-thirds of its appraised value, in accordance with the terms of the concession. On July 24, 1937, Mexico paid the Bridge Company $75,962.28 therefor (R. 22, 53-7). This sale decreased the earnings of the Company by about 40% (R. 73).

On September 14, 1937, the corporate directors, after ascertaining as against an investment cost of $206,536.90 (R. 60) a net capital loss of $68,630.53 on the enforced sale of the Mexican end of the bridge, voted to distribute to the stockholders the sum of $135,000.00. This represented the net sum ($75,877.48) received from the sale to Mexico and most of the sum of $62,029.89 reserved for depreciation

of the Mexican end of the bridge (R. 23-4, 58-62). On October 12, 1937, the stockholders approved this action and formally resolved a decrease of capital stock from $500,000.00 to $250,000.00; appropriate charter amendment being approved by the Secretary of the State of Texas on October 23, 1937 (R. 24-5, 62-66).

At the time of these transactions there was no intention or purpose to completely liquidate, terminate or dissolve the corporation.

This reduction of capital stock was accomplished by reducing the par value of the shares from $100.00 to $50.00 per share, each certificate being endorsed:

> "Authorized capital stock decreased from $500,000.00 to $250,000.00 in accordance with resolution of stockholders at meeting held October 12, 1937, par value each share reduced from $100.00 to $50.00." (R. 26, 66).

Then the endorsed certificates were returned to the stockholders, and the $135,000.00 was distributed to them in the latter part of 1937 (R. 26, 66, 76-7).

The Petitioner and wife, during 1937, received $23,706.00 of the $135,000.00 distribution, but reported none of this amount as taxable income in their income tax returns for that year (R. 26, 66).

Petitioner has contended throughout that the $135,000.00, out of which he received his part as a stockholder, was a distribution of capital in partial liquidation of the corporation and should be treated as in part payment for the one-half of the stock that was cancelled and redeemed, when substantially one-half of the capital assets (the Mexican end of the bridge) was sold by the corporation.

The Commissioner has conceded that if there was a partial liquidation of the Company, as defined by Section

115(i), then this distribution was not a taxable dividend to the stockholders (R. 29).

Both Courts below held that this distribution was a taxable dividend, but the Circuit Court of Appeals has somewhat confused the issue, as later shown (post, pp. 5-6), in the latter part of its opinion, by a clear misinterpretation of the Tax Court's opinion as to this being a dividend out of earnings and profits under Section 115(g).

Section 115 of the Revenue Act of 1936, in the portions here applicable, is set out in the appendix hereto.

II.

JURISDICTION.

1. The jurisdiction of this Court is invoked under the provisions of U. S. C. A., Title 28, Chapter 9, Section 347(a).

2. The date of the decision of the Circuit Court of Appeals sought to be reviewed is March 3, 1944 (R. 87). A petition for rehearing was timely filed on March 21, 1944 (R. 95), which was considered and overruled without additional opinion on March 25, 1944 (R. 101).

3. The one question here presented was duly raised by the Petitioner in the Tax Court (R. 3-4). After its determination by the Tax Court (R. 27), with dissent (R. 41), against Petitioner (R. 37-8), Petitioner filed his petition for review by the United States Circuit Court of Appeals for the Fifth Circuit (R. 42), assigning as error the holding of the Tax Court, in its various aspects, that there was no partial liquidation of the Laredo Bridge Company in 1937 (R. 47-9).

4. In the Tax Court, the case was consolidated with its companion case of *Sallie Ward Beretta vs. Commissioner*

of Internal Revenue (R. 52), she being the wife of the Petitioner herein, but the Circuit Court of Appeals, upon granting the petition for review, directed that only the record in this cause be printed, and that further proceedings in the wife's cause should be suspended to abide the final result of this cause. (R. 82-3).

5. The Circuit Court of Appeals, again with dissent (R. 93), held that there was not a distribution in partial liquidation of the corporation (R. 87), and Petitioner in his petition for rehearing therein complained of the error of the Circuit Court of Appeals in that regard. (R. 95).

III.

QUESTION PRESENTED.

The sole question for decision here is whether the $135,000.00 distribution by the Company was a capital distribution "in partial liquidation" of the corporation, as being "in complete cancellation or redemption of a part of its stock" (Sec. 115 (i)), so as to be "treated as in part payment in exchange for the stock" under Section 115(c) of the Revenue Act of 1936.

Petitioner contended for an affirmative answer to this question, but in addition urged several other contentions, which he now directly abandons.

Respondent contended simply for a negative answer to the question above stated, but in addition he made a counter-contention to one of Petitioner's abandoned contentions, which counter-contention the Circuit Court of Appeals has apparently misinterpreted as an original contention by the Commissioner (R. 90), for in the last three paragraphs of its Opinion (R. 92-3) that Court decides such supposed contention upon the erroneous theory that it in itself is determinative of the case.

Thus, the Circuit Court of Appeals says that the Commissioner contended that the $135,000.00 distribution was a dividend out of earnings and profits, and the decisions cited by the Court as supporting this base such holding on a construction of Section 115(h) of the Revenue Act. The opinion of the Tax Court, however, clarifies the confusion about the contentions made, in this manner:

> "We interpret his (the Commissioner's) brief to concede that if there was a partial liquidation of the company as defined by Section 115(i), then the $135,000.00, which the company distributed in 1937 in alleged partial liquidation, was not a taxable dividend to the stockholders. In other words, we interpret the Commissioner's present position *to rest squarely upon the proposition that there was no partial liquidation of the company* in 1937; that, there being none, there were taxable dividends under Section 115(a) and (b), provided there were sufficient accumulated earnings of the corporation after February 28, 1913, or earnings and profits of the taxable year, with which to pay the dividends." (R. 29).

The Tax Court then, after deciding that there was no partial liquidation of the company under Section 115(i), proceeds to dispose of Petitioner's alternative contention as above stated, holding on this and another abandoned contention against the Petitioner (R. 30-40), but leaving the primary issue of no partial liquidation under Section 115(i), as here now presented, completely determinative of the case if such issue had been determined in favor of the Petitioner.

Thus, as fully determinative of this case, we have here presented, as the sole question for decision, whether the $135,000.00 distribution by the company was a partial liquidation of that company under the precise terms of the definition of Section 115(i) of the 1936 Revenue Act.

This question, in turn, involves two points:

First, whether, as wrongly held by the Circuit Court of Appeals, an intention and purpose to completely liquidate, terminate and dissolve the corporation is essential to any partial liquidation; and,

Second, whether a reduction in the par value of corporate stock can be a complete cancellation or redemption of a part of such stock.

IV.

REASONS RELIED UPON FOR ALLOWANCE OF THE WRIT.

1. The Circuit Court of Appeals has here rendered a decision on the first point above stated (that partial liquidation must be a step in complete liquidation) in direct conflict with the decisions of the same and other Circuit Courts of Appeals on the same matter, in the following cases:

Commissioner vs. Quackenbos, 78 F. (2d) 156 (2d Cir.);

Commissioner vs. Cordingley, 78 F. (2d) 118 (1st Cir.);

Malone vs. Commissioner, 128 F. (2d) 967 (5th Cir.);

Kelly vs. Commissioner, 97 F. (2d) 915 (2d Cir.).

2. The Circuit Court of Appeals has here rendered a decision on the second point above stated (that reduction in par value of stock is not a complete cancellation or a redemption of a part of such stock) in direct conflict with the decisions of the same and other Circuit Courts of Appeals on the same matter, as follows:

Commissioner vs. Straub, 76 F. (2d) 388 (3rd Cir.);
Bynum vs. Commissioner, 113 F. (2d) 1 (5th Cir.);
Malone vs. Commissioner, 128 F. (2d) 967 (5th Cir.);
Patty vs. Helvering, 98 F. (2d) 717 (2d Cir.).

3. On the decision of both of these points, as well as on the ultimate question of no partial liquidation, by the Circuit Court of Appeals, there is recorded a dissent by Circuit Judge Sibley (R. 95). In addition, on the same points and questions, with written opinion, there is a dissent in the Tax Court by Presiding Judge Murdock, who says in part:

> "The word 'stock', as used in the statute, does not mean stock certificates, but even if it did, the stock certificates are completely cancelled in part, that is, to the extent of one-half, where the par value is reduced 50%." (R. 41).

4. The opinion of the Circuit Court of Appeals herein does not discuss or distinguish any of the above cited conflicting decisions, although all of them were pressed upon the attention of the Court in Brief for Appellant.

5. The Circuit Court of Appeals has herein, on the two points and one question above shown, rendered a decision on an important matter of Federal law, which has not been, but definitely should be, settled by this Court, out of regard for the taxpayers of this country, to-wit: construing Section 115 and subdivisions (c) and (i) thereof of the Revenue Act of 1936.

6. Section 115 of the Revenue Act of 1942 is in the particulars here involved substantially identical with Section 115 in the Revenue Act of 1936. Therefore, it is the

more important to the public interest that the conflict of decisions in this matter be resolved and the true construction of the income tax law presented in this case, as being typical of the same problems now presented to taxpayers under the 1942 Revenue Act, be settled once and for all by this, the highest Court in the land.

7. In this connection, the 1943 and 1944 Revenue Acts make no change in Section 115 or any other provisions affecting the matter here at issue.

WHEREFORE, Petitioner prays that Writ of Certiorari issue under the seal of this Court, directed to the United States Circuit Court of Appeals for the Fifth Circuit, sitting at New Orleans, Louisiana, commanding said Court to certify and send to this Court a full and complete transcript of the record and the proceedings of said Court had in the case numbered and entitled on its docket as No. 10,-621, *John K. Beretta, Appellant, vs. Commissioner of Internal Revenue, Appellee*, to the end that this cause may be reviewed and determined by this Honorable Court, as provided by the statutes of the United States, and that the judgments herein of both Courts below be reversed by this Court, with direction to the Tax Court that judgment therein be entered in favor of the Petitioner; and for such relief as to this Court may seem proper.

Dated June 20th, 1944.

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BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINIONS OF THE COURTS BELOW.

The opinion of the Tax Court is reported in 1 T. C. 86, (R. 27). Its decision is found on R. 41.

The opinion of the Circuit Court of Appeals for the Fifth Circuit is reported in 141 F. (2d) 452 and is found on R. 87. The judgment of that Court is found on R. 94.

No opinion was written on rehearing, but the order overruling petition for rehearing is found on R. 101.

II.

JURISDICTION.

1. The date of the decision of the Circuit Court of Appeals sought to be reviewed is March 3, 1944 (R. 88). The petition for rehearing was timely filed on March 21, 1944 (R. 97), and it was considered and overruled without additional opinion on March 25, 1944 (R. 103).

2. The jurisdiction of this Court is invoked under the provisions of U. S. C. A., Title 28, Chapter 9, Section 347(a).

3. A more detailed statement with respect to the jurisdiction of this Court is found under corresponding caption in the Petition, pages 4 to 5 hereof, and a Statement of the Reasons Relied on for the Allowance of the Writ is also set forth in the Petition, pages 7 to 9, to both of which reference is here made.

III.

STATEMENT OF THE CASE.

A statement of all matters material to this controversy has been made in the Petition under the caption "SUMMARY STATEMENT OF THE MATTERS INVOLVED", pages 1 to 4, which is here adopted and made a part of this Brief.

IV.

SPECIFICATIONS OF ERROR.

1. The Circuit Court of Appeals erred in holding that the $135,000.00 distribution made by the corporation in 1937 was not a distribution in partial liquidation, and erred in not holding that it was a capital distribution "in partial liquidation of the corporation, being in complete cancellation or redemption of a part of its stock" (Section 115(i)), so as to be "treated as in part payment in exchange for the stock", under Section 115(c) of the Revenue Act of 1936.

2. The Circuit Court of Appeals erred in holding that an intention and purpose to completely liquidate, terminate and dissolve the corporation is essential to any partial liquidation.

3. The Circuit Court of Appeals erred in holding that a reduction in the par value of corporate stock cannot be a complete cancellation or redemption of a part of such stock.

V.

ARGUMENT.

Explanation of the Issue Presented.

An outline summary of the argument can be found in the subject index. The authorities relied upon by Petitioner as supporting his several contentions are cited in the

Petition herein (ante, p. 7), in the first two paragraphs under the caption "Reasons Relied Upon For Allowance of the Writ."

As previously more fully shown (ante, pp. 5-6), Respondent concedes that if there was a partial liquidation in 1937, the distribution by the Laredo Bridge Company of Petitioner's part of the $135,000.00 was not a taxable dividend to Petitioner, as a stockholder (R. 29). If it was in partial liquidation in the sense of Subdivisions (c) and (i) of Section 115, no question ever arises about the application of Subdivisions (g) and (h) of this section. In other words, the amount received by Petitioner out of the $135,000.00 distribution was not taxable as a dividend out of earnings and profits, within Subdivisions (g) and (h), because, as a distribution of capital in partial liquidation, it was not taxable.

This is very well illustrated by the holding in *Patty vs. Helvering*, 98 F. (2d) 717, opinion by Circuit Judge L. Hand, wherein it is said:

> "As there used (meaning in Section 115(g)), 'taxable dividends' include all dividends other than 'liquidating dividends', for all others are taxable in fact, and 'liquidating dividends' alone are not taxable * * *. Therefore we hold that if redeemed shares have been issued bona fide, Section 115(g), 26 U. S. C. A., Section 115(g), never applies." See also *Commissioner vs. Quackenbos*, 78 F. (2d) 156; *Kelly vs. Commissioner*, 97 F. (2d) 915; *Commissioner vs. Cordingley*, 78 F. (2d) 118.

This same distinction is recognized in *Commissioner vs. Brown*, 69 F. (2d) 602, (7th Cir.), where it is said, again referring to the subdivisions of Section 115:

> "Subdivision (g) makes an exception, but does not turn every partial liquidation into a dividend

> whenever there are undistributed earnings in the corporation. On the contrary, in such a case the partial liquidation is to be treated as the equivalent of a dividend only when made under certain specified circumstances. It is the time and manner of the liquidation, not the existence of undistributed earnings, which makes the distinction (distribution) essentially equivalent to a taxable dividend."

We therefore make no question about the correctness of the holding of the Circuit Court of Appeals that this distribution should otherwise be deemed to have been made from the profits of the corporation, rather than its capital or reserves. This could not render this distribution taxable, under the plain showing of the Tax Court's opinion herein (R. 29), provided it was a partial liquidation within the meaning of the law.

Thus, is presented as the only question for determination: Was this distribution in partial liquidation of the corporation under the precise terms of Subdivisions (c) and (i) of Section 115 of the Revenue Act of 1936, the pertinent provisions of which section are shown in the appendix hereto?

This, in turn, resolves itself into the two questions discussed by the Circuit Court of Appeals, to-wit, whether intent and purpose of ultimate complete liquidation are essential to any partial liquidation under the provisions of the law, and whether a reduction in the par value of stock constitutes a complete cancellation or redemption of a part of such stock, under the above provisions.

The Manifest Meaning of Subdivision (i) of Section 115 is that Intent and Purpose of Ultimate Complete Liquidation is not Essential to Every Partial Liquidation.

A mere reading of the definition of *partial liquidation* as given in Subdivision (i) would seem to settle this matter. It provides as follows:

> "As used in this section the term 'amounts distributed in partial liquidation' means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock."

The term quoted and defined in this provision refers to the same identical term as used in Subdivision (c) of this section. As stated in the definition, there is included within its meaning both a distribution in complete cancellation or redemption of a part of the stock, as well as *"one of a series"* of such distributions of "all or a portion of its stock."

Thus, by virtue of this definition, the distribution mentioned in Subdivision (c) is a capital distribution (1) whether it is a single one in complete liquidation of all stock, (2) whether it is one of a series in complete liquidation of all stock, (3) whether it is one of a series in complete liquidation of a portion of the stock, or (4) whether such distribution is a single isolated one in complete liquidation, cancellation or redemption of a part of the stock.

Certainly this last class does not contemplate an eventual winding-up or liquidation of the corporation, but merely the complete liquidation of only a part of its stock. On the other hand, class (1) above covers such winding-up and liquidation of the corporation all at once, class (2) such an effectual winding-up by degrees, and class (3) an expected

but abortive winding-up and liquidation of the corporation by degrees. This leaves for class (4)'s coverage only the situation here presented—a single isolated "distribution by a corporation in complete cancellation or redemption of a part of its stock," being the first thing mentioned in the above definition.

To imply an intent and purpose of ultimate complete liquidation of the corporation and all of its stock as an essential incident to this class is to read into the law something that is not remotely implied thereby. Still worse, it amounts to implying something directly contrary to the plain implication in the full text of the law.

Why mention "a distribution by a corporation in complete cancellation or redemption of a part of its stock" as a class in itself, if it must be "one of a series of distributions in complete cancellation or redemption of * * * a portion of its stock"? The idea conveyed by the word "series" is that other later distributions are contemplated at the time of the making of the one in question, which, of course, would be appropriate to the idea of a final complete winding-up of the corporation and cancellation of all of its stock. The absence of any such expression in the definition of the first class mentioned in Subdivision (i) affirmatively excludes the implication of the idea of other later distributions being contemplated at the time of the making of the one in question. Only by such construction can we avoid the result that Congress has in its definition of "partial liquidation" intentionally confused by specifying as a class in itself "a distribution by a corporation in complete cancellation or redemption of a part of its stock", when "partial liquidation", in the sense of the law, could be had only through "one of a series of distributions."

The Decision of the Circuit Court of Appeals Ignores this Manifest Meaning of Subdivision (i).

The opinion of the Circuit Court of Appeals completely ignores the statutory definition of "partial liquidation." It does not even resort to the general definition of that term as given in 31 Words and Phrases, (perm. ed.), 126-7, but instead prefaces its discussion by a citation from that authority's definition of "liquidation." It then declares that there must be an intent and purpose to liquidate and wind-up a corporation, in order for there to be a partial liquidation, citing for this only *Holmby Corporation vs. Commissioner*, 83 F. (2d) 548 (9th Cir.), and *Canal Commercial Trust & Savings Bank vs. Commissioner*, 63 F. (2d) 619 (5th Cir.).

These cases throw no light on the necessity of a partial liquidation being a step in the winding-up of a corporation. In the Holmby case the Board of Tax Appeals found that certain distributions made to stockholders by a corporation that was eventually wound-up were not made "in the ordinary course of business" and that each such distribution was "*one of a series* of distributions in complete cancellation and redemption" of its stock. It was concerning such distributions that the Court said that the determining element was whether they were made "after deciding to quit and with intent to liquidate the business", citing the Canal-Commercial Trust case. The opinion in the latter is by Judge Sibley, who dissented in the case at bar, and the same expression about the determining element concerning a distribution is used. Subdivision (i) is not even involved.

The cases relied upon by Petitioner (ante, p. 7) are completely ignored by the Circuit Court of Appeals.

The Decision of the Tax Court Admits Intent to Completely Liquidate Unessential to Partial Liquidation, if this Present Involved Distribution is in Complete Cancellation of Part of Such Stock.

In contrast to the Circuit Court of Appeals, the Tax Court frankly concedes the force of the authorities relied upon by Petitioner, but undertakes to limit the application of those sustaining the point that intent to completely liquidate is not essential to partial liquidation to instances where there is a complete retirement of some of the shares of stock, rather than a reduction in par value of all the stock, and further to limit the application of those authorities sustaining the point that a reduction in par value of stock is a complete cancellation or redemption of a part of such stock to instances where the distribution in question is one of a series of distributions in complete liquidation of the corporation. As later shown, this is a distinction without a difference. (Post, pp. 27-8). We quote from the Tax Court's opinion:

> "There is no contention by Petitioners in the instant case that the 1937 distribution in question was one of a series of distributions made in the complete and final liquidation of the Laredo Bridge Company * * *. So it cannot be said that in 1937 a complete liquidation of the corporation was under way or that the distribution in question was one of a series of distributions to be made in the complete liquidation of the company. If it could be said that such was the case, then the fact that none of the corporation's shares were cancelled and retired as a result of the distribution would not be material and *the method used of reducing the par value of the stock from $100.00 to $50.00 per share would be sufficient*, and the cases of *Bynum vs. Commissioner*, 113 F. (2d) 1, and *Commissioner vs. Straub*, 76 F.

(2d) 388 (cited in support of Petitioner's second point, but not discussed by the Circuit Court of Appeals), affirming 29 B. T. A. 216 *would be in point* * * *.

"Petitioners argue, however, that *there can be a partial liquidation of a corporation without there being an intent to completely liquidate* the corporation and cease business. *That, of course, is true.* The Court points out that fact in its decision in *Commissioner v. Quackenbos*, 78 Fed. (2d) 156, wherein it is said:

" 'The force of the Commissioner's contention that the distribution was not a partial liquidating dividend such as is governed by section 115(c) because the corporation was not at the time planning a cessation of business or in the process of final liquidation is hard to perceive. When sub-section (c) refers to amounts distributed "in partial liquidation", *it nowhere limits such distributions to payments made in the course of winding-up the corporation.* Moreover, Article 625 of Regulations 74 provides that: "The phrase 'amounts distributed in partial liquidation' means a distribution in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock." *A redemption of a part of the stock of a corporation,* whether it be of all of a class such as of preferred stock, or of a part of the common stock, *has no necessary relation to the winding-up of the corporation.*'

"So this brings us to the question * * *. Was the distribution in question which the company made in 1937 made in complete cancellation or redemption of a part of its stock?" (R. 31-32).

The *Quackenbos, Cordingley, Kelly* and *Malone* cases all hold intent to completely liquidate not essential.

The *Quackenbos* case and the *Cordingley* case (78 F. (2d) 118, 1st Cir.) grew out of the same identical distribution to the stockholders of the Woonsocket Worsted Mills, which effected a reduction of its capital stock by the purchase by the corporation from its stockholders of about one-third of its stock, having a par value of $100.00, at its then present value of $90.00. Being thus based on the same facts, these two decisions of the first and second Circuits supplement one another, the *Quackenbos* opinion being by Judge Augustus N. Hand and the *Cordingley* by Judge Morton. We quote from the latter:

> "It is clear that the statute contemplates partial liquidation of corporations accompanied by partial retirement of outstanding stock; and that amounts paid for the retired stock are not taxable dividends, except as stated in sub-section (g). *The Commissioner's contention that payments made by a corporation in exchange for its stock are taxable as dividends, except when made in pursuance of a plan for complete liquidation of the corporation, cannot be sustained.* See *Commissioner vs. Brown*, 69 F. (2d) 602, 604 (C. C. A. 7), cert. denied, 293 U. S. 579; *Commissioner vs. Babson*, 70 F. (2d) 304, 7th Cir., cert. denied, 293 U. S. 571."

See also *Kelly vs. Commissioner*, 97 F. (2d) 915 (2d Cir.).

Malone vs. Commissioner, 128 F. (2d) 967, is a decision of the Fifth Circuit, the opinion being written by Judge Sibley, who dissented in the case at bar. Its discussion will be more appropriately had in connection with the second point involved. For present purposes it suffices to quote therefrom as follows:

> "It is conceded that a partial liquidation may occur without an intention to discontinue business. By the definition, it occurs when a part of the corporation's stock is completely cancelled or redeemed.

A Distribution by this Corporation to Reduce the Par Value of Its Stock is One "In Complete Cancellation or Redemption of a part of its Stock", Within Subdivision (i).

The true construction of Subdivision (i) would seem to be that by the word "stock" is meant the intangible interests in the corporation, rather than stock certificates or shares of stock. As very well said by the Supreme Court of Texas in *Yeaman vs. Galveston City Company*, 106 Tex. 389, 167 S. W. 710, 720:

> "In a corporation the certificate of stock is not the stock itself; it is but a muniment of title, and evidence of the ownership of the stock. It is not necessary to a subscriber's complete ownership of the stock."

As before shown, following the involuntary sale to Mexico of the Mexican end of the bridge, the Laredo Bridge Company, on a vote of its stockholders and directors, in the same year as received (1937), distributed to its stockholders the sum of $135,000.00, being the proceeds of this sale, plus a sum reserved for depreciation of the Mexican end of the bridge. On the basis of similar corporate action, the company at the same time decreased its capital stock from $500,000.00 to $250,000.00, there being, however, no intention of going out of business. This unquestioned good faith reduction of capital stock was accomplished by reducing the par value of the shares from $100.00 to $50.00 per share, each certificate of stock being endorsed to show this corporate action.

With reference to the situation thus presented, Presiding Judge Murdock, of the Tax Court, when dissenting in this case, said:

"If a corporation reduces its capital stock by one-half, there is a complete cancellation or redemption of one-half of its stock, regardless of whether one-half of the stock certificates are cancelled or whether the par value of each certificate is cut in two. The statute defines amounts distributed in partial liquidation as a distribution 'in complete cancellation or redemption of a part of its stock.' Speaking of stock in a broader sense than mere certificates, there would be the same cancellation in each case. The word 'stock', as used in the statute, does not mean stock certificates, but even if it did, the stock certificates are completely cancelled in part, that is, to the extent of one-half, where the par value is reduced 50 per cent. Therefore, I dissent from the holding in this case that a reduction in par value, accompanied by a distribution, cannot be a partial liquidation." (R. 41).

The Straub, Bynum, Patty and Malone Cases All Hold that Reduction in Par Value of Stock is a Complete Cancellation or Redemption of a Part of such Stock.

In *Commissioner vs. Straub*, 76 F. (2d) 388 (3rd Cir.), it is said:

"The evidence, in our opinion, establishes that the distribution of 1928 was made in partial liquidation of the corporation's capital stock. This is true notwithstanding the fact that *the method was that of reducing the face value of each outstanding share and not that of reducing the number of outstanding shares.*"

In *Bynum vs. Commissioner*, 113 F. (2d) 1 (5th Cir.), it appeared that the petitioners deducted the cost of their stock from two dividends received from an oil company, contending that they were liquidating dividends. The Commissioner held that they were ordinary dividends and the

Board of Tax Appeals affirmed the Commissioner's ruling. There the company was incorporated in 1926 in Texas, and issued 112,500 shares of $1 par value. For some of its stock it acquired certain oil leases. Thereafter it drilled some wells and bought additional leases and lands. In 1935 it sold practically all of its assets, receiving some cash therefor, and paid a dividend of $1.50 per share to its stockholders, requiring the stock certificates to be turned in and have the liquidating dividend stamped thereon. The question was whether this was a cancellation or redemption of a part of the stock.

In reversing and remanding the case, the Court said:

> "While the facts are undisputed, the case presents a mixed question of fact and law. We are not bound by the decision of the Board and may draw our own conclusions from the facts. *Bogardus vs. Commissioner*, 302 U. S. 34, 58 S. Ct. 61, 82 L. Ed. 32.
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> "We do not agree with the conclusions of either the Commissioner or the Board. Many corporations have stock of no par value. One dollar a share was nominal value only. The stockholders of a corporation have an equitable interest in the net assets of the corporation, after liabilities are liquidated, which is not necessarily measured by the par value of the stock. Each stockholder is entitled to receive his pro rata of the net assets in liquidation, according to the number of shares of the stock he holds, whether it is less or exceeds the par value. *The indorsement of the liquidating dividends on the stock certificates cancelled and redeemed them to that extent.*" (Italics ours).

In *Malone vs. Commissioner*, 128 F. (2d) 967 (5th Cir.), it was determined that the reduction of the capital of a National Bank by cutting the number of its shares did not produce taxable income to the stockholders, except on a

capital gain or loss basis. Pursuant to an approved plan, 8,000 shares of $100.00 par value were reduced to 4,000 shares of $100.00 par value, and $250,000.00 was distributed to the stockholders, pro rata. The Court, speaking through Judge Sibley, in terms sufficiently distinct to indicate the exact ground of his dissent in the case at bar, said:

> "Each stockholder surrendered his stock certificate and received another for half as many shares, and also $62.50 for each old share thus extinguished * * *. *Each stockholder of course retained the same proportionate interest in the bank's assets he had before* * * *. There was no reorganization, but only a reduction of the bank's capital. There was no exchange of stock for stock. Old certificates were surrendered and new ones issued, but of precisely the same kind, just as though the surrendered stock had been in fact sold to some third person and the certificate for the remaining shares had been issued to the seller. What is applicable is Section 115(i) * * *. It is conceded that a partial liquidation may occur *without an intention to discontinue business.* By the definition, it occurs when a part of the corporation's stock is completely cancelled or redeemed."

In spite of the fact that all three of the foregoing decisions were pressed upon the attention of the Circuit Court of Appeals, its opinion refers to none of them, except in a note it shows the *Bynum* case as applying to a series of distributions. Although in the *Malone* case it is distinctly shown that each stockholder after the reduction "retained the same proportionate interest in the bank's assets he had before", it is stated in the opinion of the Circuit Court of Appeals herein, as an argument against the effectiveness of this cancellation of a part of the stock, without noticing the *Malone* case, that "each stockholder still had the same

percentage of ownership, and would receive in final liquidation the same ratio of the corporate assets", and that "no stock was cancelled so as to permit each remaining share to receive a larger proportion in future distributions of the remaining assets."

In addition to the three decisions above reviewed, wherein the matter is fully discussed, the case of *Patty vs. Helvering*, 98 F. (2d) 717 (2d Cir.), in which the opinion was written by Circuit Judge L. Hand, also involved a reduction in the par value of each share of stock from $100.00 to $70.00, and in connection with its decision on the point which has been previously quoted (ante, p 12), it was said:

> "The Commissioner does not assert that the distributions at bar were not 'in complete cancellation or redemption' of a part of the company's shares, and arguendo, we therefore assume that they were."

The Holding of the Circuit Court of Appeals That a Reduction in Par Value Cannot Be a Partial Liquidation is Answered by the Facts Of This Case.

The Mexican Government had taken practically one-half of the Laredo Bridge Company's assets, and its capital had become impaired because the company received on this enforced sale only $75,000.00 as against the investment for the Mexican end of the bridge of more than $206,000.00, and the proceeds of this sale were no longer needed to carry on the curtailed business of the company. And so, *before* the distribution of the $135,000.00, comprising the two capital items of such proceeds of sale and the depreciation reserve for the lost Mexican end of the bridge, the stockholders reduced the capital of the Company by one-half. This was accomplished by regular methods appropriate to that end.

One of these was by endorsing each outstanding certificate of stock with the recital that the par value of each share was reduced one-half.

The evident aim of Subdivisions (c) and (i) of Section 115 was to exempt from usual income tax each stockholder's capital return on his investment. In order to come within Subdivisions (c) and (i) this return to him must be a distribution by the corporation in complete cancellation or redemption of a part of its stock. But the particular form that such cancellation or redemption must take is not specified in the law, and the restriction to capital value is effectuated just as certainly if part of the value of all the shares is cancelled completely as it is when a part of all of the shares is cancelled completely. In either event there is a cancellation of a part of the corporate stock. The result, rather than the form, is the important consideration.

A part of the stock is cancelled, whether it be a part of each share of stock or a part of the aggregate number of shares. In either case it is a capital distribution because of its source, and because equally in either event it is a distribution by a corporation "in complete cancellation or redemption of a part of its stock." Whether it is a part of each share or a part of the aggregate number of shares is immaterial.

What difference does it make that not a single share was completely cancelled? One-half of the par value of all the shares was completely cancelled, the reason for this being that practically one-half of the corporate assets, the toll bridge, was sold at an enforced loss, and the proceeds of this sale ratably distributed to the shareholders. The actual value of stock may be far in excess of its par value, and again, on the other hand, the par value may be far in excess of the actual value, but, after all, the par value is the basis for corporate capitalization.

Wilcox vs. Commissioner, 137 F. (2d) 136 (9th Cir.) *is Distinguishable.*

The *Wilcox* case presents the question as to the reduction in the par value of stock by two different corporations, the Inter-Island and the Pacific, the facts and rulings as to each being similar. Section 115 of the Revenue Act of 1934, as there involved, reads substantially like the same section in the Revenue Act of 1936, as here involved, but, in addition to construing Subdivisions (c) and (i) somewhat as the Courts below in our case do, the *Wilcox* case as to both corporations turned also on Subdivision (g) of this section, and that subdivision is not involved in any way in the case at bar as now presented (ante, pp. 5-6, 11-13). Thus, as to Inter-Island, the Court said:

> "If, contrary to our view, there was a cancellation or redemption, it was, we think, at such time and in such manner as to make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend." (Citing Section 115(g)).

Then, under next to the last syllabus, almost the identical language is used about Pacific.

Neither of these corporations had made an enforced sale of substantially one-half of its assets at a loss, like the Laredo Bridge Company; nor had they disposed of any of their assets at all. Upon the contrary, there is said to have been no intention on the part of either of these corporations "to liquidate the corporation, either in whole *or in part*, or materially to curtail its business activities," and, as to Inter-Island, it is said that its policy was "to expand its operations as conditions should warrant."

Instead of the distribution as there involved being out of the proceeds of a sale of capital assets, as in our case,

it was there said as to Inter-Island "— a distribution which admittedly was made out of earnings and profits accumulated after February 28, 1913", and as to Pacific the same is said, and in addition:

> "The purpose of the reduction in capital was to distribute to the stockholders a portion of the accumulated earnings which were not required in the conduct of the business."

On the other hand, in the case at bar, the Commissioner's position is said by the Tax Court to "rest squarely upon the proposition that there was no partial liquidation of the corporation." (R. 29).

No more than the Circuit Court of Appeals in our case does the opinion in the Wilcox case even notice the previous decisions to the contrary of its holding on the reduction of the par value of stock being a complete cancellation of a part of such stock, to-wit, the *Straub* and *Bynum* cases, respectively from the third and fifth Circuits.

The Tax Court's Distinctions Are Without Any Real Difference.

The opinion of the Tax Court very well exposes one of its basic fallacies when it says:

> "There was no *complete* retirement of any part of the company's *shares of stock*, * as we understand the meaning of that term as used in Section 115(i) and the applicable regulations."

Apparently, the Honorable Tax Court overlooked the fact that the term used in Section 115(i) is not "shares of stock" at all, but just "stock", and a cancellation of a part of the stock can be effected just as certainly with a part of the value of all shares as it can be with respect to the full value of a certain number of shares. In either event, the

cancellation must be a complete cancellation—not an incomplete one.

As for the novel theory of the Tax Court that the *Straub* and *Bynum* cases are to be distinguished by the fact that each involved one of a series of distributions with the then present purpose of ultimate complete liquidation, as well as a reduction in the par value of stock, it presents a distinction without any reasonable difference. Like the Tax Court's attempted distinction of the *Quackenbos* case, that such case involves a complete cancellation of some of the shares of stock, as well as an absence of any purpose or intention whatever to wind-up the corporation, it undertakes to make the mere accidental incidents controlling. No reason is suggested why the reduction in the par value of stock comes within the definition of Subdivision (i) as being a complete cancellation of a part of the stock only when the corporation is in the process of complete liquidation, or why eventual liquidation of the corporation need not be contemplated only when the distribution is in complete cancellation of some of the shares of stock. The language as to an isolated cancellation or reduction is "of a part of its stock" and the language as to one of a series is "of all or a portion of its stock." "Part" and "portion" mean the same thing and "complete cancellation or redemption of all" would mean all value in all shares—a complete liquidation.

The truth about the matter is that the *Straub* and *Bynum* cases, combined with the *Quackenbos*, *Malone*, *Cordingley* and *Kelly* cases, make irrefutable authority for a reversal of this case, and those decisions come from the first, second, third and fifth Circuit Courts of Appeals, including some of the ablest Judges in the United States.

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*These last italics ours.

CONCLUSION.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers by granting a writ of certiorari and thereafter reviewing and reversing the decision of the Circuit Court of Appeals.

By.....

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